The Canadian-American Committee

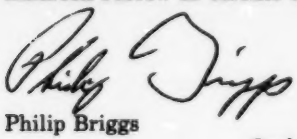
The Canadian-American Committee was established in 1957 to study and discuss the broad range of economic factors affecting the relationship between Canada and the United States. Its members are business, labor, agricultural, and professional leaders from the private sector who have direct involvement and experience in relations between the two countries. There is approximately equal membership from both nations, with the objective of obtaining representative views from the major geographic regions and industrial sectors in each. The Committee is sponsored by two nonprofit research organizations—the National Planning Association in the United States and the C.D. Howe Institute in Canada, described at the end of the volume.

The Committee believes that the maintenance of a cooperative relationship between the two countries is in the best interests of both. At the same time, the Committee recognizes that the evolution of the bilateral relationship will produce occasional strains and conflicts. Accordingly, it seeks to encourage greater public understanding of the nature of issues of bilateral importance and attempts to develop and disseminate ideas for constructive policy responses that are consistent with the national goals of the two countries.

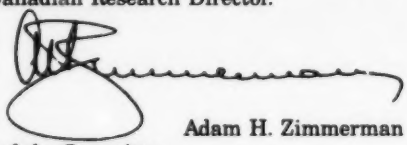
To encourage greater public understanding, the Committee sponsors objective research studies on various aspects of Canadian-American relations. These studies are prepared by experts in both countries and, with the Committee's approval, are published. On the basis of these factual studies and of discussions at its meetings, the Committee also issues policy statements signed by its members. A partial listing of Committee publications is given on the inside back cover.

The Canadian-American Committee is a unique organization in terms of both its broadly diversified membership from the private sector and its sponsorship of a coordinated publication program combining factual studies and policy-oriented statements on Canadian-American relations. It meets twice a year, once in each country; these meetings provide an opportunity for members to discuss a wide range of topics with senior government officials, scholars and other people with a specialized knowledge of the relationship. The work of the Committee is financed by funds contributed from private sources in the two countries. Foundation grants made it possible to initiate the Committee and are an additional source of financing for specific research studies undertaken by it.

Offices on behalf of the Committee are maintained at 1616 P Street, N.W., Suite 400, Washington, D.C. 20036, and at 125 Adelaide Street East, Toronto, Ontario M5C 1L7. Peter Morici serves in Washington as the U.S. Research Director and Maureen Farrow in Toronto as the Canadian Research Director.



Philip Briggs



Adam H. Zimmerman

Cochairmen of the Committee

U.S. and Canadian Auto Policies in a Changing World Environment

Paul Wonnacott

Canadian-American Committee

Sponsored by
- **C.D. Howe Institute (Canada)**
- **National Planning Association (U.S.A.)**

Quotation with appropriate credit is permissible

Library of Congress Catalog Card Number 87-62044
ISBN 0-89068-090-6

C.D. Howe Institute (Toronto, Ontario) and
National Planning Association (Washington, D.C.)

Printed and bound in the U.S.A.
July 1987, U.S. $6.00

Contents

Inside

The Canadian-American Committee ..... *front cover*

Foreword by the Committee Cochairmen ..... *v*

Executive Summary ..... *vii*

Introduction *1*

1 *The North American Auto Industry: From 1960 to the Turbulent 1980s* *3*

Canadian Auto Policy in the Early Years: 4

Prelude to the Auto Pact 4

The Bladen Report 4

The Duty-Remission Programs of 1962 and 1963 5

Automotive Products Trade Agreement of 1965 6

The Second Oil Shock and the Japanese Challenge 12

Response of North American Producers to the Japanese Challenge 13

Cost Differences 14

2 *The Internationalization of the Auto Industry* *17*

Future World Demand for Autos 18

3 *Sources of Strain on the U.S.-Canadian Auto Pact* *20*

Rise of Overseas Competition 20

Proposals for Additional Protection 20

U.S. Proposals 20

Canada: The White-Lavelle Proposals 22

Policies to Attract New Plants 24

Duty Rebates Once More 24

Grants and Other Investment Incentives 26

4 *A Summing Up* *28*

Figures

1. U.S.-Canadian Automotive Trade Balances, 1966–86 ..... *8*

2. Canadian Value Added: Requirements and Performance, 1965–82 ..... *10*

Members of the Canadian-American Committee *29*

The Canadian-American Committee's Sponsoring Organizations *34*

Selected Publications of the Canadian-American Committee ..... *Inside back cover*

Foreword

Automotive production is among the most important industrial activities affecting Americans and Canadians as producers and consumers. For more than 20 years, this sector has benefited from one of the most significant postwar policy innovations undertaken jointly by our governments to stimulate constructive interaction between the two economies. The Automotive Agreement of 1965 provides duty-free trade in new vehicles and original equipment parts in return for commitments by the four U.S. vehicle makers to exceed certain production levels in Canada. Benefiting from these circumstances, two-way trade in automotive products grew from $709 million (U.S.) in 1964 to $6 billion five years later and over $60 billion in 1986.

The Canadian-American Committee first addressed the Auto Pact during its creation as a bold solution to the predicament threatened by U.S. rejection of Canada's unilateral "duty-remission" schemes. We sponsored a seminal evaluation of its provisions and prospects by Carl Beigie, followed by a policy statement in which the Committee suggested better ways to judge the pact's operation and to deal with the contentious issues it was raising.[1]

In retrospect, these early frictions—mainly over the Canadian concepts of safeguards and Canada's "fair share" of the joint market—ultimately did not become significant. Unappreciated at the time was the fortuitous fact that the four U.S. vehicle makers had the vast North American market virtually to themselves since they alone produced the kind of moderately priced full-size cars—soon to be known as "gas guzzlers"—that most Americans and Canadians demanded.

But the privileged position of North American vehicle producers in their own market was not to last. The effects of the first oil shock of 1973 forced them to downsize their output into the range already perfected by foreign firms, most notably the Japanese. Meanwhile, multilateral trade negotiations were reducing the U.S. and Canadian external tariffs on vehicles that had defined much of the advantage that the Auto Pact granted North American producers. Soon imported Japanese cars were outcompeting our own on our home field.

A sequence of events followed. Both the U.S. and Canada protected their markets by persuading Japan to apply voluntary export restraints. Four Japanese firms then established assembly operations in the United

1. *The Canada-U.S. Automotive Agreement: An Evaluation*, by Carl E. Beigie, and *Toward a More Realistic Appraisal of the Automotive Agreement*, a Statement by the Committee. Both were published in 1970 by the Canadian-American Committee.

States. Wishing to share in this process, Canada recently adopted several measures, and considered others, to entice Japanese producers to set up production in Canada whose output would serve the U.S. market as well. To certain of these Canadian actions and proposals, the United States is now taking strong exception, with the possibility of counteraction clearly raised.

In short, the hitherto isolated North American automotive scene has become the single most important battlefield on which the major world car makers contend for market shares. Of more interest to the Committee, the competition for that market between North American and East Asian producers has now incubated actions and reactions within our two countries that could lead to a trade conflict involving this most important industrial sector.

Concerned over this prospect, the Canadian-American Committee asked Professor Paul Wonnacott of the University of Maryland to prepare a study with two objectives: to review the recent history and outlook for the North American automobile industry in a rapidly changing world environment, and to examine the future relationship between the U.S. and Canadian industries as affected by the policies each government may take to strengthen its own automotive sector.

On the latter point, Professor Wonnacott finds the growing competition for new plants creating strains between the two nations that can only grow in the early 1990s, when facilities now being planned begin production. He concludes that now is the time to face these problems, since once Japanese firms become major producers in Canada, they are likely to become more intractable.

Publication of this report by the Canadian-American Committee does not indicate that all members specifically endorse all the author's analyses or conclusions. The Committee believes, however, that the study will enlighten public discussion of an issue that promises to assume major importance between our two countries.

PHILIP BRIGGS
Cochairman

ADAM H. ZIMMERMAN
Cochairman

Executive Summary

Trade in automotive products between the United States and Canada has grown rapidly under the Automotive Products Trade Agreement of 1965 (Auto Pact). In 1986, over 7 percent of Canadian gross domestic product was accounted for by automotive exports to the United States. This study summarizes the developments in automotive policy in the two countries during the past quarter century and the prospects for the future. The principal conclusion is that the internationalization of the automobile industry is creating strains on bilateral relations between the United States and Canada. If these strains are not dealt with in the near future, it is likely that the United States will impose barriers on the entry of automotive products from East Asian firms operating in Canada.

The Auto Pact was the ultimate result of attempts by Canada to improve efficiency and increase output in its auto industry. The Bladen Report (1962) suggested, in effect, that a Canadian *value added* requirement replace the existing Canadian *content* requirement. Under Bladen's proposal, auto firms would have been required to meet target levels of Canadian value added, but would have had the option of exporting Canadian parts as an alternative to physically including them in Canadian-produced cars. In this way Canadian production would have been maintained while it was made more efficient: Canadian producers would have been able to specialize in their most competitive items. The duty-remission programs introduced in 1962 and 1963 followed Bladen's proposal in that they were designed to encourage Canadian automotive exports. However, they retained a content requirement and put a higher priority on increasing the quantity of Canadian automotive production.

The 1962–63 rebate programs constituted an indirect subsidy to exports and led to a petition for a countervailing duty by a U.S. radiator manufacturer. To avoid a confrontation, the two governments entered the Auto Pact.

While the pact provided for duty-free passage of new vehicles and most original equipment parts, it did not represent a free trade agreement because of the assembly and value added targets that Canadian auto producers were required to meet. These Canadian "safeguards" have been a source of disagreement between the two countries and reflected quite different perceptions of the pact. The United States looked on the pact as a step to free trade, with the safeguards providing only transitional protection to the Canadian industry. Canada has viewed the pact as a way of increasing efficiency while still offering protection to its industry; the safeguards were to remain to provide continuing protection.

The entry of East Asian producers into the North American market has increased the differences over the pact. There has been competition between Canada and the United States for East Asian automotive plants. The United States established an early lead, but Canada is expected to be producing a disproportionately large share of East Asian cars by the early 1990s. Canada apparently plans to become a sizable net exporter of those cars to the U.S. market. By itself, this might lead to a reaction in the United States, given the absence of a constituency in the United States to counterbalance those who will want to limit such imports.

The chances of an adverse U.S. reaction have been increased by recent steps taken by Canada to attract overseas plants. Canada remits duties on imports of overseas vehicles as a reward for the export of Canadian-made parts to the United States or other countries. Such duty rebates are particularly troublesome to the United States because they represent a revival of the 1962–63 rebate program in an even more objectionable form. In both programs, Canadian exports to the United States (and elsewhere) were promoted by duty remissions on imports into Canada. But in the 1962–63 programs, most of the Canadian imports at least came from the United States In the present program, most of the imports will come from Japan; income and jobs will be created in Japan, not the United States. If Canada does not eliminate the duty-remission program, a U.S. countervailing duty case seems probable by the early 1990s. A graceful way to eliminate the program would be to do so as part of a larger package in the current free trade negotiations.

If Japanese firms meet the safeguard levels specified in the U.S.-Canadian Auto Pact, and thus qualify for duty-free entry of parts into Canada, the same problem will arise, although in a more subtle and complex manner. Once again, Japanese firms operating in Canada will be able to use exports to the United States to earn the duty-free entry of imports from Japan.

The United States might respond in several ways. One would be to compartmentalize the Auto Pact, confining duty-free entry to North American-owned (or perhaps just U.S.-owned) firms in Canada. Another would be to press Canada to modify its Auto Pact rules to exclude overseas producers from duty-free entry into Canada. That is, Canada would be pressed to bilateralize the Auto Pact, confining the benefits to the United States, just as the United States confined the Auto Pact benefits to Canada.

Introduction

Trade between the United States and Canada is greater than between any other two countries, and a large portion of that trade is in completed automobiles, commercial vehicles and automotive parts. In 1986, the United States exported C$29.4 billion in automotive products to Canada, while Canada exported about C$34.5 billion in such products to the United States.[1] This means that almost 7 percent of Canadian GDP was accounted for by automotive exports to the United States.

The large volume of two-way trade is principally the result of the Automotive Products Trade Agreement of 1965 (APTA, also commonly known as the Auto Pact), which provided for conditional duty-free trade in automobiles, some commercial vehicles and most original equipment parts—with tires an important exception. While the APTA has been successful in its principal objective of promoting efficiency in automotive production, it has been the subject of periodic disputes. One source of continuing disagreement has been the safeguards requiring specified levels of automotive production in Canada as a prerequisite for duty-free entry.

There are two main purposes of this report. One is to review the recent history and outlook for the North American automobile industry in a rapidly changing world environment. The second is to look at the future relationship between the U.S. and Canadian industries and the principal issues between the two governments regarding automotive policies.

The report's main conclusion is that the Auto Pact is likely to come under increasing strains, and there is some danger of a sharp conflict between the two nations by the early 1990s if present policies are continued. The worst-case outcome—a termination of the APTA—seems unlikely,[2] although it would not be out of the question in certain circumstances, such as the Canadian adoption of the proposals of the 1983 Task Force on the automobile industry.[3] Such a termination would be unfortunate, both economically and politically; the integration of the U.S. and Canadian auto industries has contributed to the efficiency of the industry and to prosperity. But while the core of APTA is reasonably safe, we cannot rule out limited departures from duty-free passage, including U.S. countervailing duties on automobile exports by Canadian subsidiaries of East Asian firms.

It may be possible to deal with the auto problems as part of the current bilateral free trade talks. However, the particular issue that has generated so much heat in recent months—whether the auto industry will be part of the current bilateral negotiations—is a secondary matter.

The basis is now being laid for a future dispute. The longer the delay in dealing with the basic causes of the dispute, the more dangerous and irreversible the situation will become. Whether the areas of disagreement are addressed within the bilateral talks is not the central issue. The important point is that they be addressed somewhere, and in the near future.

The background discussion will begin in Chapter 1 with a brief history of the North American automobile industry since 1960, and then turn to developments in automotive policy in Canada and the United States. This will be followed by a review of the prospects for North American automotive producers, and the main issues between Canada and the United States regarding automotive policies. Throughout, the term "North America" is used narrowly to include only the United States and Canada.

FOOTNOTES

1. The data are the reconciled figures based on the import measures of each country.

2. Note, however, the view of Andrew R. Moroz in "Canada/U.S. Automotive Trade and Trade-Policy Issues," Ontario Economic Council, *Canada-U.S. Trade and Investment Issues*, (Toronto, 1985): "Whether or not the APTA should be quietly retired is a silent but festering question." Since Moroz's paper was published, the question has become less silent.

3. The terms of the APTA are summarized below, p. 6. The principal proposals of the Task Force are given on p. 22. The full citation is the Federal Task Force on the Canadian Motor Vehicle and Automotive Parts Industries (Patrick Lavelle and Robert White, cochairmen), *An Automotive Strategy for Canada* (Report to Hon. Edward C. Lumley, Minister of Industry, Trade and Commerce and Regional Economic Expansion, Ottawa, 1983).

1

The North American Auto Industry: From 1960 to the Turbulent 1980s

In 1960, the North American automobile industry was a comfortable oligopoly. Profits were high and reasonably stable, and the advantages of oligopoly power were shared by the labor force in the form of high wages and relatively large fringe benefits. Imports of passenger automobiles from overseas accounted for only 7.6 percent of the U.S. market (although 28 percent of the Canadian market). The North American industry made over one-half the total worldwide production of cars and had little to fear from overseas competition. Differences in driving conditions between North America and Europe provided a natural protection for the North American market, as did lower gasoline prices in North America, which resulted in North American cars being much larger than those in Europe. European cars competed only for the low end of the market and selected luxury niches. Japan was then a minor player; annual Japanese production of autos had not reached 100,000 units until 1956 and was still only a little more than a half million units in 1960. An early excursion of Toyota into the North American market in 1956, with its infelicitously named "Toyopet" model, had not been successful.

This comfortable state continued into the 1960s. After-tax returns on equity of the U.S. auto industry remained healthy (between 11.4 percent and 19.5 percent), although by the end of the decade, the gap between profit rates in autos and manufacturing in general had practically disappeared. The penetration of the U.S. market by overseas suppliers fell below 5 percent in 1962 and did not rise above 10 percent until 1968. Of the overseas suppliers, Germany maintained its predominance, although Japan was coming on strongly. In 1970, 51 percent of U.S. auto imports from overseas were from Germany, compared with 29 percent from Japan.[1]

During the 1970s, the environment for the North American auto industry changed drastically, mainly as a result of the two oil shocks of 1973–74 and 1979–80 and increasing competition from Japanese firms. The decade started well enough, with sales of North American passenger automobiles rising to a record high of 10.4 million units in 1973 (9.6 million in the United States and 0.78 million in Canada). An issue in the General Motors strike of 1973 was one sign of the times. Auto workers, tired of the long hours of required work, wanted overtime to be voluntary. But the excess of riches was soon to end abruptly. During the first oil shock, the industry was caught in a twin bind. The short-run effects of recession caused a sharp decline in total new car sales in

the United States—from 11.4 million in 1973 to 8.3 million in 1975. (However, they were still rising in Canada.) At the same time, U.S. demand was moving away from the larger North American cars toward the more fuel-efficient imports. The share of overseas imports rose from 15.2 percent of the U.S. market in 1973 to 18.2 percent in 1975, although it dropped from 24.0 percent to 18.4 percent in Canada. Japan's share was rising rapidly; by 1980, 79 percent of U.S. auto imports came from Japan and only 13 percent from Germany.

In response to the higher oil prices and government-imposed mileage requirements, the North American industry undertook a major program of downsizing. The average weight of new U.S.-built passenger cars exceeded two tons in 1972; by 1979, this figure had been trimmed by more than 700 pounds.

Despite this adjustment, the industry was more shaken by the second oil shock than the first. High gas prices were apparently here to stay; there was a sharp shift away from North American vehicles, which were still considerably heavier than the average import. And North American costs had been allowed to escalate. The North American industry had continued to act as a comfortable oligopoly, just as its oligopoly power was about to disappear. With the second oil crisis and the growing strength of the Japanese automobile industry, North American auto firms were facing their greatest challenge since the Great Depression. Before turning to the turbulent 1980s, however, we will review the background of the Auto Pact of 1965 and its main features.

CANADIAN AUTO POLICY IN THE EARLY YEARS: PRELUDE TO THE AUTO PACT

Prior to the Auto Pact, Canadian auto production was protected by a tariff and a Canadian content requirement. If cars included Canadian content equal to 60 percent of their value, car producers were permitted to import parts equal to the remaining 40 percent duty free (except for engines, to which a special duty applied).

In the late 1950s, the Canadian government became increasingly concerned over the unhealthy condition of the industry and its low productivity compared to the U.S. industry. The government was interested in two objectives: *increasing automotive production* in Canada, while *keeping costs to consumers within politically acceptable levels*. A simple increase in tariffs would meet the objective of promoting greater Canadian production, but it would have the clear disadvantage of raising prices to consumers. The only way to achieve both objectives was to develop new policies that would promote efficiency.

The Bladen Report

The problem was dropped in the lap of Dean Vincent Bladen of the University of Toronto, who was appointed a one-man Royal Commission

on the Automobile Industry. Bladen identified short, fragmented production runs as the principal cause of inefficiency. As a solution, he suggested the idea of "extended content." To qualify for duty-free importation of parts, Canadian automobile companies in Canada would still have to meet the 60 percent Canadian content requirement. However—and this was Bladen's principal innovation—the Canadian-produced content would not actually have to be "contained" in cars produced in Canada; it could be exported instead. In effect, Bladen recommended that the Canadian *content* requirement be replaced with a Canadian *value added* requirement, although this major innovation was obscured by his term "extended content." As long as the 60 percent production target was met, automotive companies would qualify for duty-free importation of *any* amount of parts. To meet the companies' production target, additional imports would of course require additional exports. Thus, the purpose of Bladen's proposal was to encourage auto producers in Canada to specialize in longer, more efficient production runs, exporting much of their output in exchange for additional imports.[2]

The Duty-Remission Programs of 1962 and 1963

Although Bladen's proposals were aimed at improving efficiency, they fell short of another government objective: a major increase in Canadian automotive output and employment. To achieve this goal, the Canadian government substantially modified Bladen's proposals before introducing them. Specifically, the 1962–63 duty-remission programs retained the requirement that the 60 percent Canadian content be actually contained in Canadian cars. This meant that the effects were quite different from Bladen's proposals. The Bladen Plan would have permitted additional imports for additional exports on a *one-for-one* basis. The 1962–63 duty-rebate programs required a *two-for-one* response. To earn duty-free importation of engines, a Canadian automobile producer had to (1) increase exports by an amount equal to the value of the imported engines; and (2) increase the input of other Canadian parts to compensate for the engines to maintain a 60 percent Canadian content. It was hoped that the twin objectives of greater efficiency and greater output might thereby be achieved.

However, the 1962–63 duty-remission programs raised a major problem south of the border. Because auto makers were granted a rebate of the 25 percent duty on engines in reward for increasing their exports, the question arose as to whether Canada was providing a 25 percent subsidy to exports.[3] A number of U.S. parts producers thought so and complained to the government. When they failed to receive an adequate response, a Wisconsin radiator manufacturer filed suit to force the government to impose a countervailing duty, as required by law. Most observers believed that the radiator manufacturer would win. Faced with

the prospect of a U.S. countervailing duty and Canadian retaliation, the two governments initiated hurried negotiations that ended in the Auto Pact of 1965.

AUTOMOTIVE PRODUCTS TRADE AGREEMENT OF 1965

The Auto Pact provided for duty-free passage of new automobiles and original equipment parts, subject to certain conditions. On the U.S. side, automotive products were accorded duty-free entry from Canada only if they met a 50 percent North American (U.S. + Canadian) content requirement. This requirement, which is standard in regional free trade arrangements, was aimed at preventing the passage of imports from third countries through Canada and into the U.S. market.

On the Canadian side, the privilege of duty-free imports was confined to automobile manufacturers who:

> (1) maintained the pre-agreement ratio of Canadian production of vehicles to their Canadian sales of vehicles (and, in any case, not less than 75 percent);
> (2) maintained, in the production of vehicles in Canada, a level of Canadian content, measured in dollar terms, equal to that in the 1964 model year.

In addition, Canadian automobile producers submitted "letters of undertaking" to the Canadian government, committing themselves to:

> (3) increase Canadian value added by at least
> (a) 60 percent of the growth in their Canadian sales, plus
> (b) an additional C$260 million by the 1968 model year.

Observe that, with requirement #3, Canada adopted a key proposal of the Bladen Report, to replace the *content* requirement with a *value added* requirement. In so doing, it promoted the efficiency of Canadian production, subject to overall production targets. (The second safeguard specified a Canadian content, but its significance declined as the value of Canadian automobile output rose.)

Observe also that the Canadian safeguards were quite different from the content requirement for duty-free entry into the United States. The U.S. requirement protected against automotive products from third countries passing through Canada and into the United States; it did not constitute a barrier to goods produced mainly in Canada. The Canadian safeguards protected the Canadian market from both overseas and U.S. products. Because the Canadian safeguards under the pact did not provide preference to U.S. imports, Canada did not have to get a waiver under the General Agreement on Tariffs and Trade (GATT). However,

the United States did, since the agreement provided preferential duty-free treatment to Canadian auto products.

Observe, in addition, that the Canadian safeguards mean that Japanese and other overseas firms establishing plants in the United States do not gain duty-free access to the Canadian market unless they also set up plants in Canada. In contrast, overseas firms establishing plants in Canada gain duty-free access to the U.S. market if they meet the 50 percent North American content test.

Finally, note that these safeguards favored Canadian assembly over Canadian production of parts.[4] The first condition meant that Canadian producers of automobiles were committed to assemble almost as many cars as they sold in that country; under the pact, Canada can be a net exporter of completed cars to the United States, but not a significant net importer. On the other hand, Canada might be a net importer of parts and other inputs equal to 40 percent of its sales (less the C$260 million). In practice, Canada has had a large and growing surplus in completed vehicles, and the United States has had a large and growing surplus in automotive parts.[5] Overall, the balance of bilateral automotive trade has swung strongly, from a Canadian deficit of $C0.5 billion in 1965 to a small surplus in the late 1960s to a record deficit of C$3.1 billion in 1979 to a record surplus of C$5.9 billion in 1984. (See Figure 1, which includes trucks in addition to passenger automobiles. These are trade data only and do not include Canadian deficits on corporate earnings and other invisibles.) Increasing specialization is one reason for the wide swings; the overall balance depends in part on the popularity of specific models and on which models are produced in Canada.

As is generally the case, this agreement was a hybrid: it promoted common interests, while compromising or papering over points of difference.

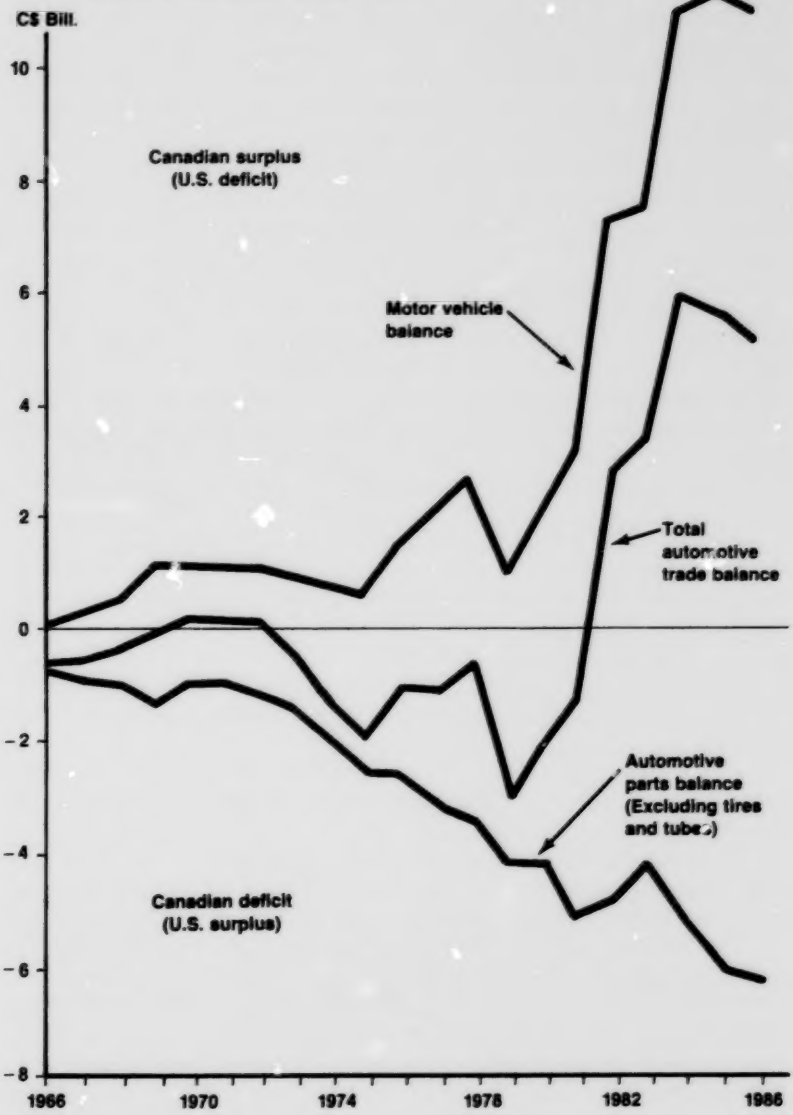
The *common interests* of the two countries were to promote the efficiency of the North American automobile industry and to prevent a potentially nasty trade war.

The *differing interests* concerned the conditions, or "safeguards," that accompanied the pact. Attitudes regarding the desirability of free trade in automobiles differ sharply between the two countries.

Through the 1960s and into the 1970s, the U.S. auto industry supported freer trade. With their international interests—particularly in Canada and Western Europe—U.S. firms stood to gain from a freer movement of parts and automobiles across borders. The U.S. government acquiesced to the Canadian safeguards on the understanding that they were transitional measures, temporarily cushioning Canadian production during an adjustment period. To the United States, the key objective of the APTA was spelled out in Article 1c (italics added):

> the development of conditions in which *market forces* may

FIGURE 1. U.S.-CANADIAN AUTOMOTIVE TRADE BALANCES, 1966–86



Source: Statistics Canada. (Data are the reconciled figures, based on the import measures of each country.)

> operate effectively to attain the *most economic pattern* of investment, production and trade.

To Canada, the principal objective was in the previous clause (Article 1b, italics added):

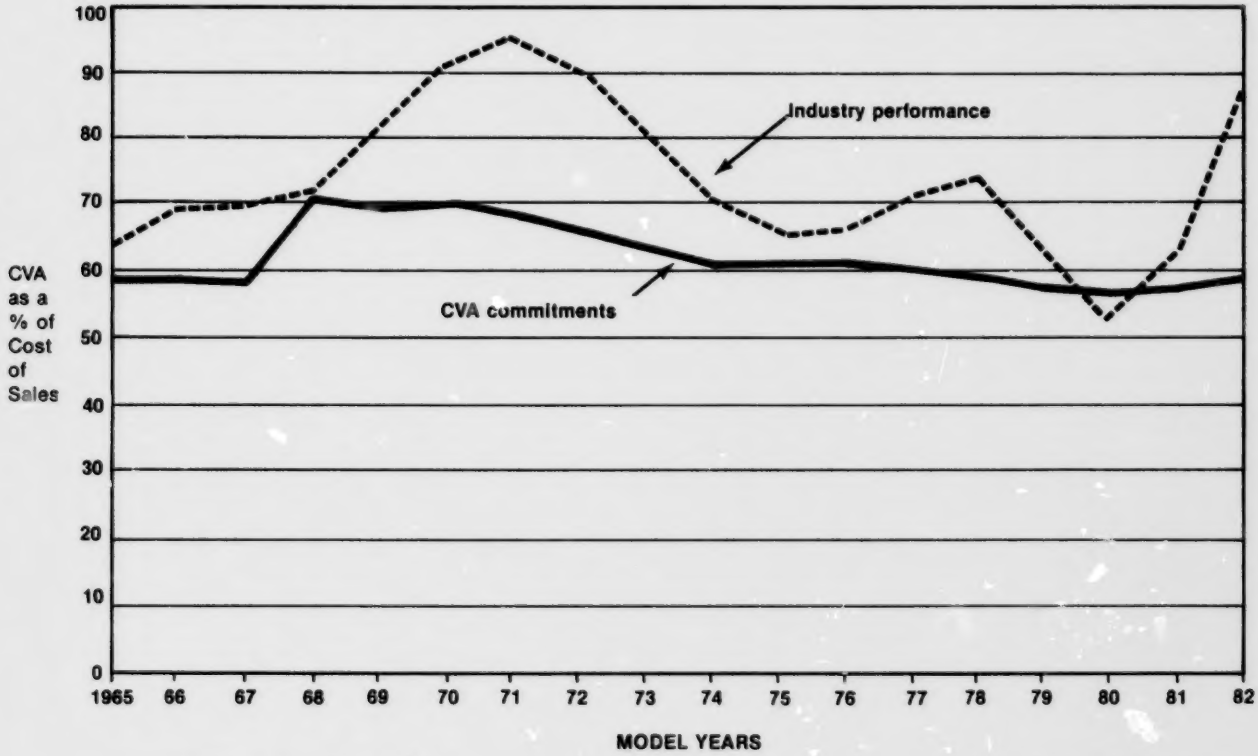
> the liberalization of United States and Canadian automotive trade in respect of tariff barriers and other factors tending to impede it, with a view to enabling the industries of both countries to participate on a *fair and equitable basis in the expanding total market* of the two countries.

Canada was to be ensured its fair share of automotive production, and the Canadian view hardened that the safeguards were a permanent fixture of automotive policy. There were two reasons. First was the traditional motive of protection, to maintain and improve the industry's position in the face of import competition.[6]

Second was the view that Canadian factories were likely to lose out in the competition for contracts, even when their costs were equally low, because the Canadian auto assemblers were owned in the United States and decisions made in Detroit. In the United States, this idea perhaps seemed fanciful, as Americans consider their market to be the most open, competitive and free-wheeling in the world, and with some justification. When overseas exporters can increase their car sales in the United States from 0.5 million in 1964 to 1.5 million in 1975 and to 2.5 million in 1980, it is hard to understand how market imperfections (other than government policies such as tariffs and voluntary export restraints) can be considered a substantial barrier to sales. Nevertheless, there is some fragmentary evidence of a U.S. tendency to buy domestic products. For example, when a suggestion was made at a 1978 board meeting of Ford to buy Japanese or Canadian steel because it was superior and cheaper, Henry Ford II reportedly responded: "We're a steel company ourselves, . . . [and I] don't like us going and buying Japanese and Canadian steel." A compromise was worked out, to buy specialty foreign steel until it became available from U.S. producers. Price was not to be a condition; availability was.[7]

To summarize, the perceptions of APTA have been quite different on the two sides of the border. To the United States, it has been a sectoral free trade agreement, with temporary, transitional assurances for the Canadian industry. With the elimination of tariffs, market forces gave Canada a fair crack at the North American automotive market.[8] To Canada, fairness has meant the reservation of a fair and equitable share for Canadian producers, when the natural tendency of Americans is to favor American producers. To Canada, the APTA is a *market sharing* arrangement—with tariff elimination, to be sure, to allow more efficiency

FIGURE 2. CANADIAN VALUE ADDED: REQUIREMENTS AND PERFORMANCE, 1965–82



Source: Federal Task Force on the Canadian Motor Vehicle and Automotive Parts Industries (Patrick Lavelle and Robert White, cochairmen), *An Automotive Strategy for Canada* (Ottawa, 1983), p. 29.

through longer production lines. Canada's objective has *not* been to *eliminate* its protection and move to free trade, but rather to make its protection *more efficient*, to promote both efficiency and additional production, and also to lower costs to consumers.

In practice, the APTA has provided Canada with most of the advantages of the 1962–63 programs. Although the 60 percent Canadian value added provision in the letters of undertaking followed the one-for-one approach of Bladen (rather than the two-for-one of the 1962–63 programs), the added requirement of C$260 million ensured an increase in production in Canada. And the Auto Pact has given Canada an additional, *major* advantage in its quest for longer, more efficient production runs: Canadian automobile producers no longer have to pay U.S. duties to break into the U.S. market.

The safeguards have been a periodic source of dissatisfaction in the United States, particularly in 1968, 1971 and 1976. In 1968, the review provided in the Auto Pact took place. The United States was miffed by Canadian unwillingness to discuss a phasing out of the safeguards. In August 1971, when Nixon's new economic policy was designed at Camp David, the decision was made to announce the abrogation of the Auto Pact. The objective was not to actually terminate the pact, but to pressure Canada to eliminate the safeguards. (The abrogation announcement was deleted from the U.S. Treasury's press release at the last minute because of objections from the State Department.) In 1975–76, the Senate Finance Committee asked the U.S. International Trade Commission to investigate whether Canada had "fully complied with the letter and spirit of the agreement by phasing out the so-called 'transitional provisions.' " The USITC reported that Canada had not done so.[9] To the United States, the first safeguard represented a particularly odd idea of "fair share" since the United States was prevented from being a significant net exporter of completed autos to Canada, while Canada was free to compete duty free as a significant net exporter of completed autos to the U.S. market.

Nevertheless, the safeguards have not constituted, and probably will not in the future constitute, a mortal threat to the Auto Pact. During the 1975 hearings of the USITC, a broad range of witnesses were heard—automobile manufacturers, parts manufacturers on both sides of the border, and labor. Despite U.S. resentment over the safeguards, the theme was: "Don't terminate the agreement."[10] Since 1980, when the auto producers fell slightly short of the Canadian value added requirement, the firms have exceeded the safeguards by an increasing margin (Figure 2). For the immediate future, the safeguards are not an important determinant of the bilateral trade account—although the unpredictability of bilateral trade flows means that the safeguards may still be influencing decisions, even if they are met by a substantial margin.

The automotive and overall trade deficits with Canada are a source of concern, but the U.S. desire for an improvement is likely to be focused

not so much on the safeguards, but on the high Canadian tariffs in nonautomotive sectors, and possibly on the exchange rate.[11] The greatest threat to harmonious bilateral relations on automotive questions now comes from a new source—the increasing internationalization of the world auto market. The pressure on North American producers from Japanese and other foreign firms and how Canada and the United States are responding to this challenge are discussed in the next section.

THE SECOND OIL SHOCK AND THE JAPANESE CHALLENGE

As noted at the beginning of this chapter, the first oil shock of 1973–74 was a rude disturbance to the U.S. automobile industry. Car sales fell, the import share increased, and profits dropped in 1974–75 to less than one-half their rate in 1972–73. But by 1977–78, new car sales in the United States had recovered to an annual rate of almost 11 million, near their 1973 peak of 11.4 million. The non-Canadian import share stabilized around 18 percent, and auto profits rose above the level of 1972–73.

While the first oil shock was disturbing, the second was devastating. The combination of soaring gasoline prices and recession caused a decline in U.S. automobile sales from 10.3 million in 1979 to 7.8 million in 1982, and from 1.00 million to 0.71 million in Canada. Furthermore, the higher oil prices caused a sharp shift away from North American cars toward overseas imports. The share of imports in the U.S. market rose from 17.8 percent in 1978 to 22.7 percent in 1979 to 28.2 percent in 1980 and to 29.3 percent in 1982. In Canada, the increase was even sharper, from 17.5 percent in 1979 to 20.2 percent in 1980 and to 31.4 percent in 1982. (For both the United States and Canada, the overseas share of commercial vehicles was substantially smaller, less than 10 percent in 1978 and between 15 percent and 20 percent in 1982; but it was rising rapidly.) For the first time in recent history, each of the North American Big Three automobile producers suffered a net loss. Chrysler teetered on the brink of bankruptcy, only to be resuscitated by a government-guaranteed loan and new management. Ford was in deep trouble.

These factors created a major shift in U.S. automotive trade policy. The U.S. auto firms had traditionally favored free trade, focusing on the desirability of reducing foreign trade barriers including local content requirements that limited U.S. exports to a large number of countries.[12] As late as 1979, UAW president Douglas Fraser expressed his appreciation of "the benefits of liberal trade."[13] But in 1980, the UAW joined with Ford to petition for escape clause relief. By a 3 to 2 vote, the U.S. International Trade Commission held that imports did not constitute a "substantial cause of injury" within the meaning of Section 201 of the Trade Act of 1974; that is, they were not a cause that was "impor-

tant and not less than any other cause." (They were not as important as the overall decline in new car sales.) Several bills were thereupon introduced in Congress with the objective of pressuring the Japanese to agree to "voluntary" export restraints (VERs). On May 1, 1981, Japan undertook to reduce exports to the United States by 7.7 percent during the fiscal year. This represented a limit of 1.7 million units in the year from April 1, 1981 to March 31, 1982. This figure was continued for three years. After increases in 1984 and 1985, it reached a rate of 2.3 million vehicles.

Canada likewise negotiated VERs with Japan, beginning at a level of 174,000 units in fiscal 1981. One motivation was to keep Canada from becoming the dumping ground for Japanese firms facing restrictions in the U.S. and other markets.

The VERs increased auto output, employment and prices, and contributed to the sharp recovery of profits in the U.S. auto industry. In 1980, the Big Three had collectively suffered a net loss of $4 billion; by 1984, they achieved their highest profits ever—$9.8 billion. The U.S. distributors of Japanese cars were also major gainers: they enjoyed easy sales at inflated markups. The net effects on Japanese auto producers were unclear. Their sales were depressed, but their profits per unit rose. The VERs forced Japanese firms to behave in a way that would have landed the executives of domestic firms in jail. In cooperation with the Japanese government, the Japanese firms "conspired" to restrict sales and raise prices to North American consumers.

An effect of the VERs that was not accurately foreseen when they were introduced in 1981 was a change in the composition of exports to the North American market. The VERs restricted the number of units, not the value of exports. This increased the incentive for Japanese firms to move up-scale, into the market for higher priced models such as the Toyota Camry, and thus pose a threat to the high end of the market that North American firms have found so profitable.

Response of North American Producers to the Japanese Challenge

In the face of the Japanese challenge and the crisis of the early 1980s, the North American producers have responded vigorously.

First, they have taken steps to become leaner—closing plants, paring overheads and sharply reducing their break-even points. These steps have inflicted severe short-term pain, including the reduction of production-line and white collar jobs and the closing of a number of plants. The timing of these painful steps depended on the dangers facing the firms. With the prospect of imminent bankruptcy, Chrysler acted first, slashing its overhead at the beginning of the decade. Next was Ford, which found itself in a somewhat less dangerous, but still precarious position. Finally, General Motors is now in the process of a major cut-

back, involving the closing of 11 U.S. plants, partially in response to its poor performance in the second half of 1986.

Second, North American firms have stressed quality and, in so doing, have narrowed the quality gap with the Japanese. As measured by problems per new car, North American producers have improved significantly since 1980, reducing problems from more than 3.5 to about 2.5. While the Japanese have kept their superior reputation for fit and finish, they have had some difficulty in maintaining their very high standards. Their problems per car have crept upward as output has grown, also contributing to the narrowing of the quality gap.[14] Nevertheless, the Japanese continue to lead in small and medium-size engines with improvements such as the four-valve cylinder, and they are leaders in engine ceramics as well.

Third, North American firms have taken steps to cut costs by tighter inventory control and by the increasing use of outside suppliers, including independent domestic parts producers and foreign producers.

Cost Differences

Quality and design have been two reasons for the strong Japanese challenge to the North American industry. Price has been another.

A number of analysts have studied cost differences between Japan and the United States during the period of intense Japanese competitiveness between 1980 and 1984.[15] Most concluded that the Japanese had a cost advantage over U.S. producers of $1,500 to $2,000 for landed automobiles. One reason was the high productivity of Japanese auto firms. In 1970, it took about 25 percent more labor hours to produce a car in Japan than in the United States (250 hours vs. 200 hours). During the 1970s, however, Japanese productivity grew rapidly, with the result that the typical Japanese car required about 30 percent fewer labor hours by 1980.[16] During the early 1980s, this differential appeared to be narrowing, although the crudeness of the labor hour measure means that even sizable changes may not be very significant. In particular, a move toward additional outsourcing in the United States means that reductions in hours per vehicle exaggerate the increase in productivity.[17]

Another cause for the competitive pressure on the North American auto industry was the undervaluation of the yen, particularly between 1982 and 1985. However, this Japanese advantage has rapidly disappeared with the decline in the dollar from more than Y260 in early 1985 to about Y140 by mid-1987.

This sharp fall in the price of the dollar has done much to eliminate the Japanese cost advantage.[18] During 1985 and 1986, Japanese firms absorbed much of the effect of the exchange rate changes, causing severe pressures on their profit margins. The soaring costs of Japanese firms, when measured in dollars, have greatly reduced the importance of the

VERs. There is some question whether Japanese car manufacturers would now export more than the allotted 2.3 million units to the United States, even if they were free to do so.

The realignment of exchange rates has had two other important effects. By greatly reducing the relative cost of North American locations, it has increased the incentives for Japanese firms to establish and expand manufacturing operations on this continent. It has also given Japanese manufacturers an incentive to look toward the newly industrializing countries (NICs), such as Korea, as inexpensive sources of components and low cost locations for manufacturing.

FOOTNOTES

1. Motor Vehicle Manufacturers Association of the United States, *World Motor Vehicle Data* (Detroit, 1986 ed.), pp. 364–368.

2. Royal Commission on the Automobile Industry (the Bladen Commission), *Report* (Ottawa, 1962). For a detailed study of the way in which Bladen's proposals would have promoted efficiency, see Paul Wonnacott, "Canadian Automotive Protection: Content Provisions, The Bladen Plan, and Export Incentives," *Canadian Journal of Economics and Political Science* (Feb. 1965), pp. 412–427. A much more critical evaluation was presented by Harry G. Johnson, "The Bladen Plan for Increased Protection of the Canadian Automobile Sector," *Canadian Journal of Economics and Political Science* (May 1963), pp. 212–238.

3. The Bladen Plan might have raised the same issue, since the export of auto products would have earned duty-free import of other auto products. However, as the Bladen Plan was not adopted, this point was never tested.

4. In this respect, the Auto Pact was quite different from the 1962 duty-remission program, which favored Canadian parts production over assembly. See Peter Morici, Arthur J.R. Smith and Sperry Lea, *Canadian Industrial Policy* (Washington: National Planning Association, 1982), p. 102.

5. Ibid. The authors point out that such statistics can give a distorted picture, since they do not recognize that many U.S.-made parts return to the United States in Canadian-assembled cars.

6. The White-Lavelle Task Force (*An Automotive Strategy for Canada*, 1983, p. xi) cites the Auto Pact as the "latest and most successful" of a series of Canadian policies aimed at meeting "any threat to Canada's fair share in automotive manufacturing relative to domestic consumption." It further states (p. xvii) that "The Canada-United States Automotive Products Trade Agreement (APTA) established the fundamental policy that automotive companies that participate in the Canadian market invest, provide employment, and create value within that market commensurate with the benefit they derive from it." For a more recent reiteration of the view that protection of the Canadian industry is an important feature of the Auto Pact, see Robert White, "Auto Pact Protects, Free Trade Does Not," *Financial Post* (Toronto), July 26, 1986, p. 8.

7. As reported by David Halberstam, *The Reckoning* (New York: William Morrow, 1986), p. 609.

8. For example, U.S. International Trade Commissioner Italo H. Ablondi expressed the view that "decisions made in the corporate offices in Detroit . . . are based on the best interests of the multinational corporations irrespective of United States or Canadian national interests. . . . These decisions . . . are usually made with the ultimate objective of maximum profits. . . ." (Letter to Senator Russell B. Long, included in U.S. Congress, Senate Committee on Finance, *Canadian Automobile Agreement*, Washington, Jan. 1976, p. vii.)

9. U.S. International Trade Commission, *Report on the United States-Canadian Automotive Agreement: Its History, Terms, and Impact*, included in Senate Committee on Finance, 1976, ibid., p. v. For a summary of U.S. views on the safeguards, see Philip H. Trezise, "Relevance of the Auto Pact to Other Sectoral Arrangements," *Canada-U.S. Law Journal* (1985), Vol. 10, pp. 63–74.

10. As summed up by Commissioner Ablondi (letter to Senator Russell B. Long, included in Senate Committee on Finance, 1976, p. ix).

11. For further discussion on the bilateral exchange rate issue, see Paul Wonnacott, *The United States and Canada: The Quest for Free Trade*, with an appendix on the exchange rate by John Williamson (Washington: Institute for International Economics, March 1987).

12. An extensive list of countries with domestic content requirements is provided in U.S. International Trade Commission, *The Internationalization of the Automobile Industry and Its Effects on the U.S. Automobile Industry* (Washington, June 1985, USITC publication 1712), pp. 16–17. (See also pp. 77–81 for details on the auto policies of Mexico, the second-best market for U.S. auto exports. Partly because of domestic content requirements, and partly because of the shift away from U.S.-type cars, U.S. auto exports to Mexico fell by more than 50 percent between 1981 and 1983—from $1.9 billion to $0.8 billion.)

13. As quoted by I.M. Destler, *American Trade Politics: System Under Stress* (Washington: Institute for International Economics, 1986), p. 72. Destler provides details on the changing attitudes of the auto union and industry (pp. 69–72).

14. Jeremy Main, "Detroit's Cars Really Are Getting Better," *Fortune* (Feb. 2, 1987), pp. 90–98.

15. The studies of the early 1980s are summarized in U.S. International Trade Commission, *A Review of Recent Developments in the U.S. Automobile Industry Including an Assessment of the Japanese Voluntary Restraint Agreements* (Washington, Feb. 1985, USITC publication 1648), pp. 37. Broader issues of competitiveness are studied in Peter Morici, *The Global Competitive Struggle: Challenges to the United States and Canada* (Toronto and Washington: Canadian-American Committee of the C.D. Howe Institute and the National Planning Association, 1984).

16. Alan Altshuler et al., *The Future of the Automobile*, Report of MIT's International Automobile Program (Cambridge, Mass.: MIT Press, 1984), p. 160.

17. USITC, *A Review of Recent Developments*, p. 38.

18. Altshuler et al., *The Future of the Automobile*, pp. 155–158, estimate a Japanese production advantage of more than $1,500 at an exchange rate of Y215 = US$1, and an advantage in excess of $800 at a rate of Y185 = US$1. This suggests that there may no longer be a substantial difference in production costs between the United States and Japan at the present exchange rate.

2

The Internationalization of the Auto Industry

Twenty-five years ago the auto industry was concentrated in North America and Western Europe. Japan's rise—from a producer of fewer than 100,000 units per year in 1959 to the largest volume producer a mere 21 years later—has been the most visible sign of the internationalization of the auto industry. But there have been others, including the ambitious attempts of some Third World countries (notably South Korea, Mexico and Brazil) to become serious participants in the automotive export market.

By the late 1970s, industry observers were writing of the coming "world car." With the downsizing of North American vehicles, cars produced in various nations were becoming more alike. Analysts foresaw the prospect of a reduction in the number of car-producing firms, each making no more than a few models. The same models would be produced in the company's plants in different countries, allowing the firm to capture economies of scale on a worldwide basis.

In recent years, expectations have changed. There are now doubts that the world car, as earlier perceived, will ever evolve, since nations differ greatly in terms of driving conditions, tastes, and affluence.[1] As a result, cars will have to be modified, particularly their suspensions and drive trains, for specific national markets. However, companies will be able to use similar designs and many interchangeable components in their products for a large number of countries. This will facilitate the international procurement of components.

Other important features of the internationalization of the industry include:

Ties among firms in different nations: for example, Chrysler with Mitsubishi; Ford with Mazda; and GM with Isuzu, Toyota, Suzuki, and Daewoo. Japanese firms will be participating in the North American market in four ways—through direct exports to their marketing subsidiaries; through marketing arrangements with U.S. firms (for example, Mitsubishi's Colt for Chrysler); through production subsidiaries (for example, Honda's plants in the United States and Canada); and through joint production arrangements (for example, the Toyota-GM plant in California). In addition, both Japanese and North American producers are developing ties in new producing nations, most notably Korea. For example, Daewoo is producing the LeMans for GM to market in North America.

The changing emphasis in protection, away from import substitution *toward export promotion*. An early step in this direction was the evolution of Canadian policy in the 1960s away from content protection toward value added targets. The growing auto industry in the developing countries of East Asia is strongly export-oriented. Closer to home, Mexican content provisions have been supplemented with tax incentives for exports and requirements that parts imports be offset with exports. As in the Canadian policies of the 1960s, there have been twin objectives—more production and more efficient production.

This change in emphasis toward export promotion will contribute to efficient, large-scale production. One of the strongest messages to be derived from the experience of the past 20 years is that export orientation—including export promotion—is a surer way to development than import-substitution policies. However, this change in emphasis creates several dangers. As promoted exports enter an increasingly competitive international market, the possibilities of squabbling over shares increase, particularly when governments try to carve out shares with quantitative targets. Second, exports are particularly vulnerable to foreign reactions in the form of countervailing duties or other constraints.

In this regard, a rethinking of international rules may be desirable. International organizations (such as the GATT and the International Monetary Fund) generally take a stronger stand against export subsidies than tariffs. (For example, the GATT Subsidies Code flatly prohibits export subsidies for nonprimary products, while the GATT has no flat prohibition on tariffs. This is not entirely surprising; the GATT must practice the art of the possible, and a prohibition on duties would be universally ignored.) Yet, perhaps, tariffs and other barriers to imports are more likely to adversely affect world efficiency than are export incentives. But such a rethinking is unlikely to occur soon, if ever; it is hard to reconsider policies on industrial subsidies when agricultural subsidies are so far out of hand. Current automotive policies should accordingly be developed with an understanding of the vulnerability of promoted exports.

FUTURE WORLD DEMAND FOR AUTOS

The entry of new participants promises to make an already competitive world market even more competitive. Their new capacity, combined with the change in the composition of demand, will increase the number of North American plants that are becoming obsolete. The threat of excess capacity is intensified by the slower-than-expected worldwide growth in demand.

In 1984, the International Automotive Program at the Massachusetts Institute of Technology presented a study on *The Future of the Automobile*, which included a summary of estimates of the future world

demand for passenger cars.[2] This summary illustrates how sharply forecasts for future sales have been revised downward. The MIT group cited two studies done in 1977 and 1978, whose average forecast for passenger car demand in 1990 was 49.2 million. Two studies in 1982 (including the work of the Organization for Economic Cooperation and Development) gave an average forecast of 37.5 million units for 1990. The 1984 MIT forecast was 37.0 million units by 1990. More recent estimates are even lower; in 1986, Data Resources, Inc. forecast worldwide sales of 34.1 million units for 1990.

In its study of the outlook for the auto industry, the OECD emphasized two interrelated factors as determinants of the future demand for automobiles: the average life of vehicles and scrapping rates.[3] Partly because of the competitive pressures to improve quality, expected vehicle lifetimes are rising, thereby depressing forecasts of future demand. For the consuming public, the improvement in quality has clearly been a desirable development. But auto manufacturers as a group may suffer from their own success: their improved quality will depress their future sales. In this respect, auto producers may face the same problem, although less severe, that confronted tire manufacturers when their markets declined with the advent of the long-lived radial tire.

FOOTNOTES

1. See U.S. International Trade Commission, *A Review of Recent Developments in the U.S. Automobile Industry Including an Assessment of the Japanese Voluntary Restraint Agreements* (Washington, Feb. 1985, USITC publication 1648), p. 3.

2. Alan Altshuler et al., *The Future of the Automobile*, Report of MIT's International Automobile Program (Cambridge, Mass: MIT Press, 1984), p. 116.

3. OECD, *Long Term Outlook for the World Automotive Industry* (Paris, 1983), p. 24.

3

Sources of Strain on the U.S.-Canadian Auto Pact

RISE OF OVERSEAS COMPETITION

The Auto Pact came into effect when the North American auto industry's position was secure; the pact was based on the assumption that the North American industry would maintain this dominance.

With the rise of Japanese and other overseas producers, this assumption has ceased to be valid. The increasing strength of Japanese producers—and particularly their decision to start assembly operations in North America—has shown the limits of the pact. The pact provides a high degree of assurance that North American-based auto producers will continue their relatively free passage across the U.S.-Canadian border. But Japanese and other overseas subsidiaries in Canada or the United States lack this assurance because of *existing rules* and *potential new legislation*. There are prospects that the North American auto market will become partially redivided, with integration continuing for the U.S.-owned firms while subsidiaries of overseas firms face barriers in trade between the United States and Canada.

In Canada, the existing value added requirements mean that a Japanese firm cannot export duty free from the United States to Canada unless it also produces in Canada. That is, a Japanese firm whose sole North American manufacturing operation is in the United States is subject to the 9.2 percent duty on cars entering Canada. This is an incentive, even for firms with relatively modest North American sales, to set up an assembly operation in Canada as well as the United States. Proposals for new restrictions in Canada would greatly increase this incentive.

In the United States, proposed legislation aimed at protecting the auto industry would have a similar effect of limiting access to the U.S. market by the Canadian subsidiaries of overseas firms.

PROPOSALS FOR ADDITIONAL PROTECTION

In this section, we look at proposals for additional protection in the United States and in Canada. The "stick" of protective legislation may force overseas firms to engage in domestic production in both North American countries if they want to keep their sales in both countries. In the next section, we will study a related topic—the "carrots" that Canada and the United States are offering to Japanese and other overseas firms to induce them to set up auto plants in North America.

U.S. Proposals

In the United States, legislation calling for a U.S. *domestic content*

requirement has been submitted on a number of occasions to Congress. Companies selling cars in the United States would be required to meet minimum domestic content, ranging up to 90 percent for firms selling over 900,000 vehicles. If an auto firm failed to meet the requirement, its imports of vehicles and parts would be reduced the following year. A domestic content bill passed the House of Representatives in 1982 and 1983, but met strong opposition elsewhere. The Reagan Administration was flatly opposed. William Brock, the U.S. Trade Representative in 1982, called it "the worst piece of economic legislation since the 1930s," while Senator John Danforth declared that the "overwhelming majority" of the members considered it "perfectly ridiculous."[1]

Like the requirements of the Bladen Plan or the Auto Pact safeguards, the proposed U.S. content requirement would have been a value added requirement, rather than a strict content requirement. That is, exports would have counted; the U.S. content would not actually have to be "contained" in cars sold in the United States. Consequently, the U.S. content provision would not have disrupted the central foundation of the Auto Pact as it applies to North American-owned firms. The large volume of trade in both directions could have continued between the United States and Canada; the U.S. assembly plants of GM and other U.S.-owned firms would not have been forced to switch away from the use of Canadian parts. The content provision would, however, have substantially affected the major overseas sellers of cars to the U.S. market (six Japanese and one German firm). They would have been forced to either produce in the United States or partially retire from the U.S. market. Canadian products would not have counted in achieving the content requirement. Thus, the Canadian subsidiaries of overseas auto firms would not have had equal access to this segment of the U.S. market.

A second proposal was Congressman John D. Dingell's "Made in America" bill that, if enacted, would have temporarily *restricted imports of motor vehicles* to 15 percent of the number sold in the United States in the previous year. However, the quota *apparently would not have applied to imports from the Canadian subsidiaries of U.S. auto firms* (H.R. 1050, Feb. 1985, Ap. G, p. 3).

Thus, neither the content bill nor the "Made in America" bill would have greatly disturbed the Auto Pact as it applies to North American-owned firms; neither bill would have required them to reduce their shipments from Canada to the United States. However, both types of legislation would have prevented Japanese and other overseas manufacturers from gaining unrestricted access to the U.S. market from Canadian plants.

Furthermore, the proposed bills did not actually have to pass to have an effect on Canada. The *threat* of such legislation, combined with other pressures on the Japanese to set up shop in the United States, gave the Japanese an incentive to establish plants in the United States in preference to Canada in the early 1980s. By 1985, about 330,000 vehicles (including

trucks) were produced by Japanese firms operating in the United States (Honda, Nissan and Toyota in conjunction with GM), but no Japanese firm was producing in Canada. Canadian frustration was reflected in the conclusion of Andrew Moroz several years ago, that "Canada has few levers to influence the trade and investment decisions of the major offshore vehicle manufacturers."[2] As noted earlier, the Auto Pact safeguards provide one incentive to set up shop in Canada—without Canadian assembly plants, a Japanese firm producing in the United States cannot sell duty free to the Canadian market. But this lever was considered inadequate. The development of additional levers was a goal of the Federal Task Force on the Canadian Motor Vehicle and Automotive Parts Industries (1983), headed by Patrick Lavelle, President of the Automotive Parts Manufacturers Association of Canada, and Robert White, Canadian Director of the United Automobile Workers (now President of the Canadian Auto Workers).

Canada: The White-Lavelle Proposals

The proposals of the Task Force included the following recommendations.

1. The Canadian government should extend the principles of the Auto Pact to overseas producers, *requiring* them to meet the Canadian *vehicle production* and the 60 percent Canadian *value added* provisions. Auto firms would have to produce in Canada to sell in Canada (except for firms selling less than 3,000 units per year, who could continue to import cars over the tariff).

2. Once the commitments in #1 had been reached, the Canadian government should "negotiate an agreement with all vehicle companies to *increase* the level of *minimum commitments* to the Canadian economy" (italics added). This increase would apply to U.S. as well as overseas firms.[3]

Clearly, adoption of the second proposal would have led to objections from the United States, since it would have been a unilateral tightening of the safeguards by Canada. Adoption would possibly have raised the question of whether the Auto Pact should be abrogated.

The first proposal might seem like a minor modification. Since the beginning, Canada has held the door to the Auto Pact open to overseas producers. They have had the option of earning duty-free access to the Canadian market by meeting requirements for Canadian vehicle production and value added. In fact, however, this proposal would have represented a major change in Canadian policy, from making the Auto Pact *voluntary* to making it *required* of any firm with sizable auto sales in Canada. One current option—to import over the Canadian tariff—would have been closed. If adopted, this proposal would presumably have raised objections from overseas nations

because their auto producers would be excluded from the Canadian market unless they met the value added requirements.

The proposal might also have created problems in the United States about the terms for duty-free entry of Canadian automotive products into the U.S. market. The United States has always looked on the Auto Pact as a *bilateral* agreement, providing duty-free passage both ways. U.S. auto products can enter Canada duty free; in reward, Canadian auto products can go into the United States duty free. If Canada were to unilaterally force overseas firms to meet the Canadian vehicle and value added requirements, and hold out the promise of duty-free access to the U.S. market as an inducement, the United States might reconsider the details of the Auto Pact. Specifically, the United States might object to Japanese and other overseas producers *using duty-free exports from Canada to the United States* as a way of earning the reward of *duty-free entry of auto products from Japan into Canada*. One U.S. option would be to act unilaterally to compartmentalize the Auto Pact: duty-free entry into the United States from Canada might be limited to the products of North American-owned firms—or, possibly, just U.S.-owned firms.[4]

Note the importance of the distinction between North American-owned and U.S.-owned firms for independent Canadian-owned parts producers. If the Lavelle-White proposals were adopted, there is some danger that the independents might get caught in the cross fire and end up paying duties for entry into the United States. Dingell's "Made in America" bill, with its provision for *U.S. subsidiaries* in Canada, suggests that Canadian independents might fare badly with a change in U.S. policy. (However, that bill did not pass, and in any event, it addressed the imports of completed automobiles and did not set limits on the imports of parts.)

The White-Lavelle proposals have not been adopted. Nevertheless, the internationalization of the North American automobile market, with extensive penetration by overseas producers, promises to be a source of strain on U.S.-Canadian relations, for two reasons.

First, although Japanese and other overseas auto firms exporting to Canada are not required to fulfill the Canadian value added safeguards, they still have that option, thus qualifying for duty-free entry into Canada under the existing Auto Pact. If they do so, the problem noted above will arise: Japanese producers would use exports from Canada to the United States to earn duty-free entry for Japanese auto products into Canada. Because of concerns on this point, the U.S. government is now studying whether it would be desirable to ask the Canadian government to bilateralize the Auto Pact—that is, to limit duty-free treatment to imports from the United States.[5] If Canada were to refuse this request, the United States might consider responding in the way just noted—by limiting duty-free imports from Canada to the products of North American firms. There is an obvious advantage in settling this issue before Japanese firms become major producers within Canada.

Second, additional dangers are arising from recent Canadian policies, as we shall soon see.

POLICIES TO ATTRACT NEW PLANTS

In both the United States and Canada, proposed legislation has provided a threat to overseas firms: if they do not set up shop in North America, they may face penalties. But the carrot has also been offered—the Canadian duty-remission program and various grants and incentive packages used on both sides of the border.

The incentives have been particularly effective in Canada, with the result that the early U.S. lead in attracting overseas firms has been overcome. Whereas the United States had all 330,000 units produced by East Asian firms in North America in 1985, current projections are that Canada will have a capacity of as much as 450,000 units of such production by 1990, compared with about 1,700,000 in the United States. (These figures include both Japanese and Korean subsidiaries, and also the joint ventures of GM with Toyota in the United States and with Suzuki in Canada.)

As the Canadian share of planned production is much larger than the Canadian share of sales, Canada is apparently planning to become a significant net exporter of East Asian vehicles to the United States. This in itself creates some danger of a U.S. reaction. The danger is heightened by the way in which Canada has attracted the plants.

Duty Rebates Once More

To encourage overseas firms to buy or produce automotive products in Canada, the Canadian government has offered them a duty-remission program. For example, by exporting Canadian-made automotive parts to the United States or elsewhere, Japanese companies can earn remission of Canadian duties on imports of cars from Japan.

Particularly sensitive questions are raised by this program because of its similarity to the duty rebates of 1962–63 that precipitated a countervailing duty lawsuit. A major U.S. purpose in entering the Auto Pact was to eliminate the duty rebates that had the effect of Canadian subsidies on automotive exports to the United States. By now using somewhat similar subsidies on exports to the United States, Canada may run the risk of reviving the old charge of bad faith, leveled some years ago when Canada refused to phase out the safeguards.

The risk is heightened because of two features of the duty-remission program as it has recently been offered to Japanese auto producers: (1) it is much more objectionable, from a U.S. viewpoint, than the 1962–63 rebates; and (2) the United States has already objected to similar rebates in the late 1970s.

On the first point, duties were at least being rebated on imports from the United States under the old 1962–63 program. That is, the subsidy

to exports occurred when firms earned the remission of duties paid on Canadian *imports from the United States*. In contrast, the current Canadian duty-remission program permits Japanese firms operating in Canada to use *exports to the United States* (which are duty free under the Auto Pact) as a way to earn the rebate of Canadian duties on *imports from Japan*. As Canada is thus using the duty-free access to the U.S. market to reduce barriers to imports from Japan, this arrangement is more likely to raise political heat south of the border than did the old program of 1962–63.[6]

On the second point, the United States objected to a similar rebate arrangement for Volkswagen of Canada, introduced in 1978. Presumably as a result of U.S. objections, and in recognition of the duty-free entry into the U.S. market under the Auto Pact, the Canadian government *excluded* exports to the United States when it entered duty-remission agreements with a number of Japanese firms in 1980, with credit given only for exports *to other countries* (for example, Honda Remission Order, PC 1980–2066, paragraph 2). By 1984–85, however, in revising the agreement with the Japanese firms, the Canadian government dropped the U.S. exclusion (for example, Honda Remission Order, PC 1985–810, paragraph 2, reaffirmed in PC 1986–637, paragraph 2). As in the 1978 VW case, rebates can once more be earned by exports *to any country*, including the United States.[7]

The duty-remission program creates the danger of a major difficulty in U.S.-Canadian relations by the early 1990s; it is not too strong to call it a time bomb. Although the United States has already objected over the remissions, the greatest danger is not in the immediate future. Under present laws—in contrast to those of 1962–63—U.S. firms cannot apply for countervailing duties unless they can show injury, which they may be unable to do until subsidized Canadian exports become sizable, presumably not for several years.[8] Once Canada has plants in operation, built on the assumption of a continuing rebate, a messy situation could arise because that is when a U.S. reaction is most likely.

The coming dispute over tariff remissions will be quite different from the recent lumber case. In that instance, the applicability of the U.S. countervailing duty law was quite ambiguous. A similar petition for a CVD on Canadian lumber had been rejected in 1983, and there was a natural feeling in Canada that the U.S. law was being stretched and used for protectionist purposes. In contrast, it is hard to see ambiguities in the duty-remission program; it falls within a reasonable definition of export subsidy.

It will be difficult to solve the remission problem. The Canadian government cannot easily eliminate the remissions, since they have already been promised to foreign firms and, at any rate, the Canadian government intensely dislikes to be seen as backing down in the face of U.S. pressure. On the other hand, it is difficult to see how a straightforward application of the U.S. countervailing duty law can be avoided in the early 1990s.

The best hope for getting out of this ticklish situation is to eliminate the rebates as part of an overall package in the current free trade negotia-

tions. Canada can more gracefully give up its ticking time bomb when there are other items in the agreement that it wants.[9]

Grants and Other Investment Incentives

Other incentives, including tax breaks and interest-free loans, have been offered by locations on both sides of the border to attract or keep plants. In some cases, the sharpest bidding occurs within the United States—for example, when Pennsylvania successfully outbid Ohio for the VW plant in 1978. In other cases, Canadian and U.S. locations are in competition—such as when Canada and Ontario successfully outbid Ohio for a new Ford engine plant in 1978. Recent examples of government incentives include the interest-free loans of C$220 million from the governments of Canada and Quebec to GM for improvements to the Ste. Therese plant. Within the United States, the Ste. Therese incentives have been criticized on the ground that Canada apparently intends to prevent even the least efficient Canadian plant from closing, while 11 GM plants are being closed in the United States.

Most states and provinces would be better off if such bidding had never begun. However, once it has, many locations feel pressure to participate. Different perceptions on the two sides of the border increase the chances of a U.S.-Canadian dispute. The United States sees the competition as unfair, since the states often have to compete against the combined subsidies of the provincial and federal governments in Canada. In Canada, the threat of U.S. countervailing duties or other retaliation creates uncertainty and thus adds to the difficulties of attracting firms. Countervailing duties are sometimes advocated as a way of discouraging mutually disadvantageous bidding for plants. But such a "solution" is most unsatisfactory for Canada because of the asymmetries between the two countries. Facing the threat of a possible countervailing duty, firms would have a natural tendency to pick a U.S. location to have unhampered access to the larger market.

FOOTNOTES

1. For the political pressures for a content bill, see I.M. Destler, *American Trade Politics: System Under Stress* (Washington: Institute for International Economics, 1986), pp. 72–73, 226–228. For a summary of the proposed legislation, see U.S. International Trade Commission, *The Internationalization of the Automobile Industry and Its Effects on the U.S. Automobile Industry* (Washington, June 1985, USITC publication 1712), pp. 13–14.

2. Andrew R. Moroz, "Canada/U.S. Automotive Trade and Trade-Policy Issues," Ontario Economic Council, *Canada-U.S. Trade and Investment Issues* (Toronto, 1985), p. 314.

3. Federal Task Force on the Canadian Motor Vehicle and Automotive Parts Industries (Patrick Lavelle and Robert White, cochairmen), *An Automotive Strategy for Canada* (Report to Hon. Edward C. Lumley, Minister of Industry, Trade and Commerce and Regional Economic Expansion, 1983), pp. xiii–xiv, xvii, 107.

4. If Canada were to negotiate an Auto Pact with Japan—as suggested in the 1983 Speech from the Throne (under the Liberal government)—then the situation would become even more complicated. Specifically, if Canada negotiated a pact similar to APTA, with duty-free entry of Canadian products into Japan, then the United States would be faced with a question: does roundabout duty-free entry into the Japanese market through Canadian subsidiaries compensate for duty-free entry into the U.S. market by Canadian subsidiaries of Japanese firms? This invites the answer "no." But it is not clear that this is the right answer. U.S. tariffs on Japanese cars are low, and the Japanese market seems impossible to crack. Might Canada run interference for U.S. firms? How much would this be worth to the United States?

If the answer were in fact no, then the United States might act in the way suggested above—unilaterally compartmentalize the Auto Pact, applying duties on auto imports from the Canadian subsidiaries of overseas firms.

5. See Giles Gherson, "Auto Pact Crumbling," *Financial Post*, Feb. 16, 1987, p. 1.

6. Note that the duty-remission provision is *quite different* from the general drawback provision used by many countries, which allows the refunding of a duty already paid on a product when *that* product is *reexported*. In the Canadian provisions, a firm can earn remission of duties on completed automobiles by exporting quite different items, such as shock absorbers and brake parts, made in Canada.

Duty remissions are much more likely to cause an adverse reaction in the United States than are drawbacks. Drawbacks are recognized as legitimate under the GATT Subsidies Code. In contrast, the Canadian duty rebate may reasonably be considered an export subsidy of a type forbidden by the code. Currently, the size of the subsidy is in the range of 6 percent to 9 percent.

Although drawbacks are generally unobjectionable and nondistorting, they can cause problems in a bilateral duty-free arrangement, as explained in Paul Wonnacott, *The United States and Canada: The Quest for Free Trade* (Washington: Institute for International Economics, March 1987), pp. 136–138. With the growth of overseas imports, duty drawbacks may create difficulties between the United States and Canada, although much less severe than duty rebates. One way to deal with the problem would be to forgo both rebates and drawbacks in bilateral auto trade, or in other trade covered by a duty-free agreement.

7. The VW rebates are discussed in Gary C. Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Washington: Institute for International Economics, 1984), p. 67. Relevant excerpts from the VW and Honda agreements are reproduced as an appendix in Wonnacott, *United States and Canada: The Quest for Free Trade*, pp. 109–113.

8. The injury test was added in 1979 as a result of the GATT negotiations leading to the Subsidies Code. In 1974, another significant change was made in the U.S. countervailing duty law: CVD could be applied even to goods that would otherwise be duty free.

9. For several possible packages to deal with the issue of rebates, subsidies, and countervailing duties, see Wonnacott, *United States and Canada: The Quest for Free Trade*, pp. 102–108 and 143–146.

4

A Summing Up

Although duty-free passage across the U.S.-Canadian border has promoted the efficiency of the North American auto industry, strains on the bilateral relationship are likely to grow. A major reason is the competition for new Japanese and other overseas plants.

The chances of a negative reaction in the United States have been increased by the specific steps taken by Canada to attract overseas plants. The duty-remission program is particularly troublesome to the United States because it represents a revival of the 1962–63 rebate program in an even more objectionable form. If Canada does not eliminate the duty-remission program, a U.S. countervailing duty case seems probable by the early 1990s. One graceful way to eliminate the program would be to do so as part of a larger package in the current free trade negotiations.

If Japanese firms meet the safeguard levels specified in the U.S.-Canadian Auto Pact, and thus qualify for duty-free entry of parts into Canada, the same issue will arise—is Canada using the carrot of duty exemptions to encourage Japanese firms operating in Canada to export to the United States?

The United States might respond in several ways. One would be to press Canada to modify its Auto Pact rules to exclude overseas producers from gaining duty-free entry into Canada. Another would be to compartmentalize the Auto Pact, confining duty-free entry to North American-owned (or perhaps just U.S.-owned) firms in Canada.

Members of the Canadian-American Committee

Cochairmen

PHILIP BRIGGS
Vice Chairman of the Board, Metropolitan Life Insurance Company, New York, New York

Vice Chairman

WILLIAM D. EBERLE
Chairman, EBCO Incorporated, and President, Manchester Associates, Ltd., Boston, Massachusetts

Members

JOHN N. ABELL
Vice Chairman, Wood Gundy Inc., Toronto, Ontario

JOHN D. ALLAN
Chairman of the Board, President and Chief Executive Officer, Stelco Inc., Toronto, Ontario

PETER A. ALLEN
Chairman, President and Chief Executive Officer, Lac Minerals Ltd., Toronto, Ontario

JOHN R. ALTENAU
President and Chief Executive Officer, Manufacturers Hanover Bank of Canada, Toronto, Ontario

EDWARD ANDERSEN
Master, National Grange, Washington, D.C.

EDWIN L. ARTZT
Vice Chairman, The Procter & Gamble Company, President, Procter & Gamble International, Cincinnati, Ohio

WILLIAM D. BAKER
Senior Vice President, Alexander and Alexander, Inc., Minneapolis, Minnesota

JOHN F. BANKES
Vice President, Goldman, Sachs & Company, New York, New York

RALPH M. BARFORD
President, Valleydene Corporation, Toronto, Ontario

PETER I. BIJUR
President and Chief Executive Officer, Texaco Canada Inc., Don Mills, Ontario

R.J. BILODEAU
Chairman, Honeywell Limited, Willowdale, Ontario

ADAM H. ZIMMERMAN
Chairman and Chief Executive Officer, Noranda Forest Inc., Toronto, Ontario

JAMES T. BLACK
Chairman of the Board, The Molson Companies Limited, Rexdale, Ontario

BLAINE BOSWELL
Vice President, International, PPG Industries, Inc., Pittsburgh, Pennsylvania

DAVID I.W. BRAIDE
President, The Niagara Institute, Toronto, Ontario

C. ROBERT BURGESS
President and Chief Executive Officer, Citibank Canada, Toronto, Ontario

LAWRENCE BURKHART
President, Pacar of Canada Ltd., Canadian Kenworth Company, Mississauga, Ontario

DAVID J. BUTTERS
Senior Vice President, Shearson Lehman Brothers, New York, New York

ROBERT W. CAMPBELL
Chairman, Canadian Pacific Enterprises, Calgary, Alberta

TOM CAMPBELL
Chairman of the Board, Ontario Hydro, Toronto, Ontario

JOE E. CHENOWETH
President, Home & Building-Automation Controls, Honeywell Inc., Minneapolis, Minnesota

PETER A. CHERNIAVSKY
President, B.C. Sugar, Vancouver, B.C.

JOHN E. CLEGHORN
President, Royal Bank of Canada, Montreal, Quebec

WILLIAM COATES
Executive Vice President, International, Westinghouse Electric Corp., Pittsburgh, Pennsylvania

MARSHALL A. COHEN
President & Chief Operating Officer,
Olympia & York Enterprises Limited,
Toronto, Ontario

BASIL COLE
Counsel, Hamel and Park, Washington, D.C.

THOMAS J. CONNORS
Executive Vice President,
Operations, Pfizer International Inc.,
New York, New York

STEPHEN J. CONWAY
Senior Vice President,
Scott Paper Company,
Philadelphia, Pennsylvania

LEON COURVILLE
Senior Vice President, International,
National Bank of Canada,
Montreal, Quebec

JAMES A. CURTIS
President and Chief Executive Officer,
Milliman and Robertson Inc., Seattle,
Washington

A.J. deGRANDPRE
Chairman, Bell Canada Enterprises, Inc.,
Montreal, Quebec

WILLIAM DIEBOLD
Upper Nyack, New York

THOMAS W. diZEREGA
Upperville, Virginia

RODNEY S.C. DONALD
Chairman, McLean, Budden Limited,
Toronto, Ontario

CHARLES F. DORAN
Professor and Director, Center of Canadian
Studies, Johns Hopkins University, SAIS,
Washington, D.C.

M. MARCEL DUTIL
President du conseil et chef de la direction,
Le Group CANAM MANAC, St. Georges,
Beauce, Quebec

WILLIAM A. ENOUEN
Senior Vice President and Chief Financial
Officer, Mead Corporation, Dayton, Ohio

STEPHEN C. EYRE
Executive Director, John A. Hartford
Foundation, New York, New York

DONALD K. FARRAR
Senior Executive Vice President, Textron,
Inc., Providence, Rhode Island

JOHN P. FISHER
President, Southam Inc., Toronto, Ontario

THOMAS F. FLEMING
President, Morgan Bank of Canada, Toronto,
Ontario

JOHN FLUKE, JR.
Chairman of the Board and Chief Executive
Officer, John Fluke Manufacturing Co., Inc.,
Everett, Washington

JOHN R. FORREST
Senior Vice President, Boise Cascade, Boise,
Idaho

FRED FOSMIRE
Senior Vice President, Human
Resources-Technology-Engineering,
Weyerhaeuser Company, Tacoma, Washington

KENT B. FOSTER
Group Vice President, Telephone Operating
Group, GTE Corporation, Stamford,
Connecticut

WILLIAM C. GARRIOCK
President and Chief Executive Officer, Miles
Laboratories Ltd., Etobicoke, Ontario

LEO GERARD
Director, District #6, United Steelworkers of
America, Toronto, Ontario

PETER GORDON
Managing Director, Salomon Brothers, New
York, New York

JAMES K. GRAY
Executive Vice President, Canadian Hunter
Exploration Ltd., Calgary, Alberta

WILLIAM HAMILTON
Executive Secretary, The Canadian
Federation of Agriculture, Ottawa, Ontario

JOHN A. HANNAH
President Emeritus, Michigan State
University, East Lansing, Michigan

MILTON E. HARRIS
Chairman and President, Harris Steel Group
Inc., Toronto, Ontario

WILLIAM B. HARRISON
Executive Vice President, Chemical Bank,
New York, New York

ARDEN R. HAYNES
Chairman, President and Chief Executive
Officer, Imperial Oil Limited, Toronto, Ontario

J. PAUL HELLSTROM
Managing Director, The First Boston
Corporation, New York, New York

LAWRENCE C. HOFF
President, The Upjohn Company, Kalamazoo,
Michigan

E. SYNDEY JACKSON
Chairman, The Manufacturers Life Insurance Company, Toronto, Ontario

VERNON T. JONES
President, The Williams Companies, Tulsa, Oklahoma

JANET W. KETCHAM
Director, West Fraser Timber Co. Ltd., Vancouver, B.C.

JOHN F. KEYDEL
Executive Director, Touche Ross International, New York, New York

JAMES M. KILTS
President, Kraft Limited, Montreal, Quebec

MICHAEL M. KOERNER
President, Canada Overseas Investments, Toronto, Ontario

B.K. KOKEN
President and Chief Executive Officer, Abitibi-Price Inc., Toronto, Ontario

MARC LALONDE
Stikeman, Elliott, Advocates, Montreal, Quebec

LANSING LAMONT
Director, Canadian Affairs, Americas Society, New York, New York

SPERRY LEA
Washington, D.C.

PHILIP B. LIND
Senior Vice President, Rogers Cablesystems Inc., Toronto, Ontario

FRANKLIN A. LINDSAY
Chairman, Vectron, Inc., Cambridge, Massachusetts

PIERRE LORTIE
Chairman and Chief Executive Officer, Provigo Inc., Montreal, Quebec

DONALD S. MACDONALD
McCarthy & McCarthy, Toronto, Ontario

H. IAN MACDONALD
President Emeritus and Director, York International, York University, Downsview, Ontario

HARTLAND M. MacDOUGALL
Chairman, Royal Trustco Ltd., Toronto, Ontario

ROBERT M. MacINTOSH
President, The Canadian Bankers' Association, Toronto, Ontario

JOHN MACNAMARA
Chairman and Chief Executive Officer, The Algoma Steel Corp. Ltd., Sault Ste. Marie, Ontario

RAYMOND MAJERUS
Secretary-Treasurer, United Auto Workers, Detroit, Michigan

RICHARD MALYAN
President, Latin America and Canada, Bristol-Myers International Group, New York, New York

PAUL M. MARSHALL
President and Chief Executive Officer, Westmin Resources Limited, Calgary, Alberta

EDWARD E. MASTERS
President, National Planning Association, Washington, D.C.

JAMES G. MATKIN
President and Chief Executive Officer, Business Council of British Columbia, Vancouver, B.C.

A.V. MAURO
President and Chief Executive Officer, The Investors Group, Winnipeg, Manitoba

JAMES A. McCAMBLY
President, Canadian Federation of Labour, Ottawa, Ontario

ALLAN D. McLEOD
Corporate Secretary, Saskatchewan Wheat Pool, Regina, Saskatchewan

JAMES A. MERRILL
Senior Vice President and Chief International Economist, Marine Midland Bank, N.A., New York, New York

JOHN MILLER
Vice Chairman, National Planning Association, Washington, D.C.

WILLIAM MOELLER
Executive Vice President, The First National Bank of Chicago, Chicago, Illinois

FRANK J. MORGAN
President and Chief Operating Officer, The Quaker Oats Company, Chicago, Illinois

FRANK E. MOSIER
President, The Standard Oil Company, Cleveland, Ohio

J.J. MUNRO
President, Western Canadian Regional Council No. 1, International Woodworkers of America, Vancouver, B.C.

OWEN J. NEWLIN
Senior Vice President, Pioneer Hi-Bred International, Des Moines, Iowa

ROBERT G. NICHOLS
Partner, Price Waterhouse, New York, New York

JAMES R. NININGER
President, The Conference Board of Canada, Ottawa, Ontario

M.J. O'BRIEN
President and Regional Manager, Boise Cascade Limited, Ft. Frances, Ontario

GORDON OSBALDESTON
Senior Fellow, School of Business Administration, University of Western Ontario, London, Ontario

RONALD W. OSBORNE, C.A.
President and Chief Executive Officer, Maclean Hunter Limited, Toronto, Ontario

RICHARD B. PATTON
Senior Vice President, H.J. Heinz Company, Pittsburgh, Pennsylvania

GEORGE A. PEAPPLES
President and General Manager, General Motors of Canada Ltd., Oshawa, Ontario

CHARLES A. PERLIK, JR.
President, The Newspaper Guild, AFL-CIO, CLC, Washington, D.C.

CHARLES PERRAULT
President, Perconsult Ltd., Montreal, Quebec

ROBERT L. PIERCE
President, NOVA, an Alberta Corporation, Calgary, Alberta

JOHN W. PITTS
President, MacDonald, Dettwiler & Associates Ltd., Richmond, B.C.

GEORGE J. POULIN
General Vice-President, International Association of Machinists and Aerospace Workers, Washington, D.C.

WILLIAM S. RANDALL
President, Chief Executive Officer and Chairman of the Board, First Interstate Bank of Washington, N.A., Seattle, Washington

ROBERT REISER
Group Vice President and President, International Operations, Xerox Corporation, Stamford, Connecticut

DAVIS R. ROBINSON
Pillsbury, Madison & Sutro, Washington, D.C.

RAYMOND ROYER
President and Chief Operating Officer, Bombardier Inc., Montreal, Quebec

A.E. SAFARIAN
Department of Economics, University of Toronto, Toronto, Ontario

JAMES R. SCHLESINGER
Senior Advisor, Shearson Lehman Brothers, New York, New York, and Senior Advisor, Center for Strategic and International Studies, Georgetown University, Washington, D.C.

J. MICHAEL G. SCOTT
Vice Chairman, McLeod Young Weir Limited, Toronto, Ontario

JACK SHEINKMAN
Secretary-Treasurer, Amalgamated Clothing and Textile Workers' Union, New York, New York

CHARLES R. SITTER
Director and Senior Vice President, Exxon Corporation, New York, New York

RAY V. SMITH
President and Chief Executive Officer, MacMillan Bloedel Limited, Vancouver, B.C.

JOHN SWEENEY
President, Service Employees International Union, AFL-CIO, Washington, D.C.

JAMES C. TAYLOR
President, Morgan Stanley Canada Ltd., Toronto, Ontario

KENNETH D. TAYLOR
Senior Vice President, Nabisco Brands, Inc., New York, New York

W. BRUCE THOMAS
Vice Chairman-Administration and Chief Financial Officer, USX Corporation, Pittsburgh, Pennsylvania

ALEXANDER C. TOMLINSON
Executive Director, Center for Privatization, Washington, D.C.

PETER M. TOWE
Chairman, Petro-Canada International Assistance Corporation, Ottawa, Ontario

WILLIAM R. VINEYARD
General Manager, International Lighting Department, General Electric Co., Cleveland, Ohio

GEORGE E. WARDEBERG
Vice Chairman and Chief Operating Officer, Whirlpool Corporation, Benton Harbor, Michigan

R.D. WENDEBORN
Executive Vice President, Ingersoll-Rand Company, Woodcliffe Lake, New Jersey

P.N.T. WIDDRINGTON
President and Chief Executive Officer, John Labatt Limited, London, Ontario

WILLIAM P. WILDER
Chairman, The Consumers' Gas Company, Toronto, Ontario

LYNN R. WILLIAMS
International President, United Steelworkers of America, AFL-CIO, CLC, Pittsburgh, Pennsylvania

L.R. WILSON
President and Chief Executive Officer, Redpath Industries Limited, Toronto, Ontario

DEREK R. WIMMER
Vice President, Rockwell Overseas International Corp., Pittsburgh, Pennsylvania

FRANCIS G. WINSPEAR
Edmonton, Alberta

GEORGE W. WOODS
Vice Chairman, TransCanada PipeLines Limited, Toronto, Ontario

CHARLES WOOTTON
Coordinator, International Public Affairs, Chevron Corporation, San Francisco, California

Honorary Members

M.W. MacKENZIE
Ottawa, Ontario

JOHN R. WHITE
New York, New York

Sponsoring Organizations

The C.D. Howe Institute is an independent, nonpartisan, nonprofit research and educational institution. It carries out, and makes public, independent analyses and critiques of economic policy issues and translates scholarly research into choices for action by governments and the private sector.

The Institute was created in 1973 by a merger of the C.D. Howe Memorial Foundation and the Private Planning Association of Canada. The Foundation had been created in 1961 to memorialize the late Right Honorable C.D. Howe, who served Canada in many elected capacities between 1935 and 1957, including as Minister of Trade and Commerce. The Private Planning Association of Canada was a unique forum created in 1958 by leaders of business and labor for the purpose of carrying out research and educational activities on economic policy issues.

While its focus is national and international, the Institute recognizes that Canada is composed of regions, each of which may have a particular perspective on policy issues and different concepts of what should be national priorities.

A Board of Directors is responsible for the Institute's general direction and for safeguarding its independence. The President is the chief executive and is responsible for formulating and carrying out policy, directing research, and selecting staff. In order to promote the flexibility and relevance of its work, the Institute's high quality professional staff is intentionally kept small and is supplemented by a program of visiting professionals and links with a number of scholars and compatible institutions.

Participation in the Institute's activities is encouraged from business, organized labor, trade associations, and the professions. Through objective examinations of different points of view, the Institute seeks to increase public understanding of policy issues and to contribute to the public decisionmaking process.

Grant L. Reuber is Chairman, Maureen Farrow is President and Treasurer, and Margaret Brouxhon is Corporate Secretary.

The Institute's offices are located at: Suite 900, 555, boul. Dorchester ouest, Montreal, Quebec H2Z 1B1; P.O. Box 1621, Calgary, Alberta T2P 2L7; and 125 Adelaide Street East, Toronto, Ontario M5C 1L7 (Tel. in Toronto, 416-865-1904).

The National Planning Association is an independent, private, nonprofit, nonpolitical organization that carries on research and policy formulation in the public interest. NPA was founded during the Great Depression of the 1930s when conflicts among the major economic groups—business, labor, agriculture—threatened to paralyze national decisionmaking on the critical issues confronting American society. It was dedicated to the task of getting these diverse groups to work together to narrow areas of controversy and broaden areas of agreement and to provide on specific problems concrete programs for action planned in the best traditions of a functioning democracy. Such democratic planning, NPA believes, involves the development of effective governmental and private policies and programs not only by official agencies but also through the independent initiative and cooperation of the main private sector groups concerned. And to preserve and strengthen American political and economic democracy, the necessary government actions have to be consistent with, and stimulate the support of, a dynamic private sector.

NPA brings together influential and knowledgeable leaders from business, labor, agriculture, and the applied and academic professions to serve on policy committees. These committees identify emerging problems confronting the nation at home and abroad and seek to develop and agree upon policies and programs for coping with them. The research and writing for these committees are provided by NPA's professional staff and, as required, by outside experts.

In addition, NPA's professional staff undertakes research designed to provide data and ideas for policymakers and planners in government and the private sector. These activities include research on national goals and priorities, productivity and economic growth, welfare and dependency problems, employment and manpower needs, and technological change; analyses and forecasts of changing international realities and their implications for U.S. policies; and analyses of important new economic, social and political realities confronting American society. In developing its staff capabilities, NPA has increasingly emphasized two related qualifications. First is the development of the interdisciplinary knowledge required to understand the complex nature of many real-life problems. Second is the ability to bridge the gap between theoretical or highly technical research and the practical needs of policymakers and planners in government and the private sector.

All NPA reports are authorized for publication in accordance with procedures laid down by the Board of Trustees. Such action does not imply agreement by NPA board or committee members with all that is contained therein unless such endorsement is specifically stated.

NPA publications, including those of the Canadian-American Committee, can be obtained from the Association's offices, 1616 P Street, N.W., Suite 400, Washington, D.C. 20036 (Tel. 202-265-7685).

Selected Publications of the Canadian-American Committee*

CAC-56 *U.S. and Canadian Auto Policies in a Changing World Environment*, by Paul Wonnacott, 1987 ($6.00)

CAC-55 *Global Imbalances and U.S. Policy Responses: A Canadian Perspective*, by Richard G. Lipsey and Murray G. Smith, 1987 ($6.00).

CAC-54 *Outward Bound: Canadian Direct Investment in the United States*, by Alan M. Rugman, 1987 ($7.50).

CAC-53 *Bridging the Gap: Trade Laws in the Canadian-U.S. Negotiations*, by Murray G. Smith, with C. Michael Aho and Gary N. Horlick, 1987 ($6.00).

CAC-52 *Canadian-U.S. Trade Options*, a Policy Statement by the Committee, 1985.

CAC-51 *Weathering the Storm: Canadian-U.S. Relations, 1980-83*, by David Leyton-Brown, 1985 ($6.50).

CAC-50 *The Global Competitive Struggle: Challenges to the United States and Canada*, by Peter Morici, 1984 ($10.00).

CAC-49 *Acid Rain: An Issue in Canadian-American Relations*, by John E. Carroll, 1982 ($6.00).

CAC-48 *Improving Bilateral Consultation on Economic Issues*, a Policy Statement by the Committee, 1981 ($2.00).

CAC-47 *Electricity Across the Border: The U.S.-Canadian Experience*, by Mark Perlgut, 1978 ($4.00).

CAC-46 *Bilateral Relations in an Uncertain World Context: Canada-U.S. Relations in 1978*, a Staff Report, 1978 ($4.00).

*In Canada, these and other Committee publications may be ordered from Prentice-Hall Canada, Inc., 1870 Birchmount Road, Scarborough, Ontario M1P 2J7. In the United States, contact the Committee's offices at 1616 P Street, N.W., Suite 400, Washington, D.C. 20036.